Non-Ferrous Metals in Latin America: Challenges and Opportunities

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Key Messages

- Future prospects are bright in terms of “below the ground risks”. In the case of copper, according to ICSG:
  - Latin America holds about 50% of known reserves, more than 40% of world mining production, and a healthy portfolio of projects (Chile, Mexico, and Peru).
  - Latin America will continue to be the region with the largest copper mining production capacity and will maintain its share in world copper production capacity at around 38% (mainly because of Peru).

- Many Latin American countries have deliberately - or by force of circumstances - decided not to develop their mining sectors. But in places like Chile, Mexico and Peru, mining has induced greater levels of wealth and prosperity and supported a path towards advanced economies.

- Mining investment has grown exponentially in Latin America over the past decade: 27% of global exploration spending in 2014 and up to US$200 billion in new investment by 2020. However, since 2014, Chile and Peru saw a significant decline in foreign investment as mineral prices declined.
Challenges affecting non-ferrous metals in Latin America

- Latin America’s preeminence in mining cannot be taken for granted. Lower prices, rising costs, declining productivity and increasing social and regulatory pressure in community engagement and environmental sustainability are hampering the sector’s profitability and ability to remain globally competitive.

- Our presentation will focus on five factors affecting the future prospects on non-ferrous metals in Latin America:
  1. Demand
  2. Macroeconomic Stability
  3. Predictability of Legal and Regulatory Framework
  4. Competitiveness
  5. Social Conflict

1. Demand: China, China, China

- China’s consumption of non-ferrous metals - roughly half of the global total - peaked in 2013 and ebbed as the construction boom slowed.
- Beyond the debate regarding annual GDP growth rates (7%, 5%, or less), other official data clearly shows the slowdown in China’s manufacturing and residential real estate construction sectors, the county’s former economic powerhouses.
- Nominal GDP growth in China’s industrial sector grew at 1.2% in Q2 2015, down from 5% in 2014.
- For construction, Q2 growth was 4.1% compared with 9.8% last year.
- Services are now the fastest growing sector of China’s economy. The stock market boom helped output from financial services increase 27% annually in Q2 2015 but the impacts of the recent turmoil still need to be assessed.
Demand (2)

- Latin America exporters are seeing the slowdown in Chinese imports reflected in both import volumes and product value. Chinese apparent usage of copper is expected to increase only by 0.6% in 2016, compared to an apparent growth of 14% in 2014.
- Future GDP growth will be a result of expansion in services (namely financing), rather than industrial production.
- Reduced intensity of metals consumption in GDP will entail slower growth rates for metal consumption.
- In the case of steel and aluminum, Chinese excess capacity with easy access to finance will increase exports and delay price recovery.
- As a result we anticipate prices to remain at current levels over the medium term, but not as low as in previous crisis because of sustained demand. Price recovery will depend on absorbing excess capacity.

2. Macroeconomic Stability

- From early 2000s to 2014, the biggest boom in commodity prices of recent history led to huge economic growth in resource rich countries but also excessive optimism about future prospects of the sector (super cycle).
- IMF/WEO: Low commodity prices will translate in average yearly losses in GDP growth of 1-2.5% in commodity exporting countries in the next couple of years (2015-17 compared to 2012-14).
- World GDP growth in 2015 has been revised down from 3.3% to 2.8% (World Bank).
Macroeconomic Adjustment

- Latin American resource rich countries doing better than in previous recessions:
  - Relative control on public spending.
  - Less public debt (with a few exceptions).
  - Increased investment in infrastructure and social sectors (including cash transfers to the poor).
  - Substantial increase in reserves of foreign currency associated in some cases with the creation of stability funds.
  - Improved access to financing (including from domestic private sources).
  - Flexibility of exchange rates.

2. Macroeconomic Adjustment (2)

- Exchange rate will probably be a powerful tool. Examples of depreciation to the US$:
  - Euro: >10% since 2014;
  - Yen >30% since 2012;
  - Colombia’s Peso and Brazil’s Real about 40% since 2014.
- Risk of inflation in case of adjustment relying only on expansionary fiscal and monetary policies
- Macroeconomic adjustment is needed beyond demand stimulus: need for structural reforms.
3. Predictability of Legal & Regulatory Framework

- Stability of the rules, refraining from excess optimism
- Institutional strengthening for Enforcement and Compliance: don’t tax more, tax better: flexible and stable fiscal regimes, enhanced tax administration, benefit sharing with local municipalities and communities.
- Integrated planning to facilitate Regional Development: land-use planning (ordenamiento territorial), facilitating the integration of CSR and social investments by private sector into national and local development plans.
- Interministerial approval and monitoring of licensing and investments to reduce delays and uncertainty.
- Involvement from municipalities and local communities from the beginning of the process.
- Administrative simplification: licensing and environmental permits; structuring and financing of infrastructure projects; reduction of administrative barriers to private investment and financing.

4. Competitiveness

- Mining Supply: need to cut costs conserve cash. Key factors: low oil prices, currency devaluation and access to finance.
- Delay in capital investments: Projects under construction will be finished and recent completed ones will see a ramp-up in production (Peru, Mexico, and also Brazil, Chile). Marginal projects or those located in high risk countries will be delayed.
- Access to financing remains relatively easy; problem with potential increase in interest rates in the USA.
- In sum: Potential surpluses in the market expected in the next couple of years, with supply growth outstripping moderate increases in demand (copper).
5. Social conflict

- During high commodity prices mining companies were mainly focused in bringing additional production into the market, forgetting opportunities to improve efficiencies and reduce costs through precompetitive cooperation.
- Mining has the potential to act as a platform for change and economic diversification in Latin America:
  - Through advances in research and development and technological innovation it can address the challenges that hinder the productivity of the industry and of the countries.
  - Through Supply Linkages Cooperation and Public-Private Partnerships it can drive the growth of a new mining services sector that helps to diversify the economy, as well as investments in infrastructure, water, and energy.
  - Through policies that foster inclusion and constructive dialogue with workforce and communities it can enhance skills and take the lead on environmental and social sustainability.

The World Bank Group

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  - International Bank for Reconstruction and Development
  - Role: To promote institutional, legal and regulatory reform
  - Clients: Governments with per capita income between $1,025 and $6,055.
  - Products: Technical assistance, Loans, Policy Advice

- **IDA**
  - International Development Association
  - Role: To promote institutional, legal and regulatory reform
  - Clients: Governments of poorest countries with per capita income of less than $1,025
  - Products: Technical assistance, Interest Free Loans, Policy Advice

- **IFC**
  - International Finance Corporation
  - Role: To promote private sector development
  - Clients: Private companies in member countries
  - Products: Equity/Quasi-Equity, Long-term Loans, Risk Management, Advisory Services

- **MIGA**
  - Multilateral Investment and Guarantee Agency
  - Role: To reduce political investment risk
  - Clients: Foreign investors in member countries
  - Products: Political Risk Insurance
THANK YOU!

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